

121 FERC ¶ 61,108
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Westar Energy, Inc.

Docket No. ER07-1344-000

ORDER ACCEPTING AND SUSPENDING PROPOSED AGREEMENT AND
ESTABLISHING HEARING AND SETTLEMENT JUDGE PROCEDURES

(Issued October 30, 2007)

1. On August 31, 2007, Westar Energy, Inc. (Westar) filed under section 205 of the Federal Power Act (FPA)¹ a Cost-Based Formula Rate Agreement for Full Requirements Electric Service (Agreement) between itself and Kansas Electric Power Cooperative, Inc. (Kansas Electric).² In this order, we accept the Agreement subject to refund, suspend it for a nominal period to become effective November 1, 2007, and set it for hearing.

I. Background

2. Westar currently provides service to Kansas Electric pursuant to the Master Power Purchase and Sale Agreement (MPSSA) between Westar and Kansas Electric, which provides for firm capacity and energy sales by Westar to Kansas Electric from designated generating resources and for the sale by Kansas Electric to Westar of energy from certain callable generating resources. Westar entered into the MPSSA pursuant to its market-based rate authority, and the Commission accepted the MPSSA to become effective on May 30, 2003.³

3. On September 27, 2004, as amended on September 30, 2004, Westar submitted an updated market power analysis in compliance with Commission's Implementation

¹ 16 U.S.C. § 824(d) (2000).

² The agreement is designated FERC Rate Schedule No. 301.

³ *Westar Energy, Inc.*, Docket No. ER04-478-000 (March 24, 2004) (unpublished letter order).

Order.⁴ Westar's updated market power filing indicated that it passed the pivotal supplier screen in all markets considered, and that it passed the wholesale market share screen in all of the markets except for its home control area and the Midwest Energy, Inc. (Midwest) and Aquila Networks-West Plains Kansas (WPEK) control areas. On March 23, 2005, the Commission instituted a proceeding under section 206 of the FPA,⁵ concerning the justness and reasonableness of Westar's market-based rates in the Westar, Midwest and WPEK control areas. Westar proposed to use cost-based measures to address the Commission's requirements to mitigate market power. On September 26, 2006, the Commission issued an order, finding that sales with terms of more than one year should be made on an embedded cost-of-service basis.⁶

4. In light of the Commission's findings in the Mitigation Order, Westar states that it engaged in extensive negotiations with Kansas Electric regarding the terms under which Westar would provide capacity and firm energy to Kansas Electric, resulting in the proposed Agreement.

II. Description of the Filing

5. Pursuant to the proposed Agreement, Westar will supply firm energy and capacity to Kansas Electric for the retail load requirements of Kansas Electric's member cooperatives less any generation and purchased power resources of Kansas Electric. Westar will arrange for transmission, ancillary and distribution services and pass through the costs it incurs. The proposed Agreement will not expire until December 31, 2045 and shall continue thereafter on a year-to-year basis, unless cancelled by either party providing at least five years prior written notice.

6. Westar states that Kansas Electric will pay a monthly charge for the service that includes, among other charges, a demand charge. The demand charge for the first year will be \$11.89 per kilowatt; thereafter, it will be the lesser of the latest demand charge produced by the formula rate or 110 percent of the prior contract year's demand charge. Westar proposes to derive the return on equity (ROE) annually pursuant to a formula that adds 535 basis points to the average of the daily Moody's Investors Service's Long-Term Baa Corporate Bond Index for December and that is subject to a floor and a ceiling of 9 percent and 18 percent, respectively. Westar explains that any proposed changes to the proposed ROE methodology shall be subject to a "public interest" standard of review. Westar states that the demand charge and the variable operations and maintenance

⁴ *Arcadia Power Partners, LLC*, 107 FERC ¶ 61,168 (2004) (Implementation Order), *order on reh'g*, 110 FERC ¶ 61,178 (2005). The Implementation Order addressed the procedures for implementing the Commission's new interim generation market power analysis and mitigation policy announced in the Commission's April 14, 2004 Order in *AEP Power Marketing, Inc.*, 107 FERC ¶ 61,018, *order on reh'g* (2004) (SMA Rehearing Order).

⁵ 16 U.S.C. § 824e (2000).

⁶ *Westar Energy Inc.*, 116 FERC ¶ 61,219 (2006) (Mitigation Order).

(VOM) component of the energy charge will not exceed Westar's average embedded cost and that the formulas deriving the demand charge and the VOM charges will primarily use data from Westar's FERC Form 1.

7. Westar states that the Agreement provides for an effective date of "the first day of the month following the later of the date on which both [the Commission] and [the U.S. Department of Agriculture Rural Utilities Service (RUS)] approve this Agreement without condition or modification." Accordingly, Westar requests that the Agreement become effective the later of: (1) November 1, 2007, or (2) the first day of the month following the date on which the RUS approves the Agreement without condition or modification. Westar requests waiver of any requirements necessary to allow such an effective date.

III. Notice of Filing and Responsive Pleadings

8. Notice of Westar's filing was published in the *Federal Register*, 72 Fed. Reg. 52,873 (2007), with interventions and protests due on or before September 21, 2007. The Kansas Corporation Commission filed a notice of intervention. Kansas Electric filed a timely motion to intervene and comments. Timely motions to intervene and protests were filed by: Prairie Land Electric Cooperative, Inc. (Prairie Land) and Victory Electric Cooperative, Inc. (Victory), jointly; Occidental Chemical Corp. and Occidental Power Marketing, L.P. (jointly, Occidental); and Sunflower Electric Power Corp. (Sunflower) and Mid-Kansas Electric Company, LLC (Mid-Kansas), jointly. Doniphan Electric Cooperative, Kaw Valley Electric Cooperative, and Nemaha-Marshall Electric Cooperative (jointly, Kansas Cooperatives) filed a motion to intervene out-of-time. Westar and Kansas Electric filed answers. Prairie Land and Victory, jointly; Sunflower and Mid-Kansas, jointly; and Occidental filed answers to Westar's and Kansas Electric's answers. Kansas Electric filed a pleading opposing the motions for leave to respond.

9. Kansas Electric urges the Commission to accept the Agreement, as it is the product of arms-length negotiations between Kansas Electric and Westar and is in the long-term interests of each party.

10. Sunflower and Mid-Kansas argue that the proposed Agreement would impair their existing contract rights.⁷ Sunflower and Mid-Kansas state that because Sunflower's contracts with Prairie Land and Victory terminate on April 1, 2021, they are concerned that under the proposed full requirements contract, Westar would have exclusive rights to

⁷ Sunflower is an electric generation and transmission cooperative that has all requirements contracts with each of its distribution cooperative members. Two of Sunflower's members, Prairie and Victory, are also members of Kansas Electric and have all requirements contracts with Kansas Electric. All six of Sunflower's distribution cooperative members formed the new entity, Mid-Kansas, to bid for Kansas-area electric service territory and assets of Aquila, Inc. Sunflower and Mid-Kansas September 21, 2007 Protest at 3-4.

serve these two entities' capacity and energy needs, including load growth, thus interfering with Sunflower's and Mid-Kansas's contractual rights with Victory and Prairie Land. Sunflower and Mid-Kansas request that the Commission reject the proposed Agreement or suspend it and set it for hearing so that Westar can devise language to: (1) recognize explicitly the pre-existing contracts between Sunflower and each of its members and the Mid-Kansas settlement documents; and (2) state that nothing in the Agreement shall operate to modify or interfere with the rights and obligations of Sunflower, Mid-Kansas, Victory, and Prairie Land under such pre-existing contracts. In their protest, Prairie Land and Victory echo these concerns.

11. Prairie Land and Victory also argue that the proposed Agreement should be set for hearing, with a maximum suspension period, because it has not been shown to be just and reasonable and not unduly discriminatory. They assert that Kansas Electric did not have equal bargaining power with Westar, to the detriment of Kansas Electric's members, as evidenced by, among other things, a formulaic ROE that both deviates from Commission-approved methodology and is protected by a public interest standard of review. They also argue that the contract term – 38 years – is long and “once approved cannot be easily modified in the future.”⁸ Other rate matters raised by Prairie Land and Victory include concerns with the proposed Agreement's retail rate adjustment provision,⁹ waiver of the right to challenge billing in a Commission proceeding by both parties, and limitations on damages for Kansas Electric's members.

12. Occidental argues that the Agreement should be rejected, or alternatively set for hearing with a five-month suspension period. Among other things, Occidental asserts that Westar has not justified the proposed cap on the demand charge or addressed whether its shareholders and/or captive customers will be financially responsible for lost revenue if costs exceed the 10 percent cap. Occidental states that Westar's filing provides no supporting testimony or cost information on which to test the validity of Westar's proposed rates. It further argues that the use of average embedded cost is not just and reasonable because Westar has not established that revenues will exceed incremental costs or that sales are assigned the highest fuel cost generation. Occidental also avers that Westar has not justified the Agreement's potential arbitrage and cross-subsidization opportunities with respect to Westar's option to purchase power from Kansas Electric and Kansas Electric's option to acquire future coal-fired generation constructed by Westar.¹⁰

⁸ Prairie and Victory September 21, 2007 Protest at 17.

⁹ Prairie and Victory argue that this provision inappropriately shifts risk to Kansas Electric and its wholesale ratepayers, in the event a state regulatory authority were to determine that there should be a cost disallowance at the retail level for Westar's bundled retail customers that is caused in some manner by the Agreement. Prairie and Victory September 21, 2007 Protest at 18-19.

¹⁰ Occidental September 21, 2007 Protest at 16-18.

13. In its answer, Westar states that arguments that the Agreement interferes with rights under existing contracts should be rejected because the Agreement is limited by Kansas Electric's contractual arrangements with its member cooperatives. Westar further argues that the proposed Agreement represents a careful balancing of the interests of Westar and Kansas Electric and that specific provisions must be considered within the context of the whole agreement. Westar rejects suggestions that the proposed Agreement is a failed market negotiation, arguing that the Agreement is the product of extensive arms-length negotiations between Westar and Kansas Electric. Westar points to delegated letter orders issued in uncontested proceedings that accepted similar rate treatments.¹¹

14. Westar argues that its filing provides sufficient information to comply with the Commission's regulations. Further, Westar contends that the proposed Agreement does not result in a cross-subsidy and provides a study to demonstrate that incremental revenues will exceed incremental costs under the proposed Agreement. With respect to Occidental's argument that service under the proposed Agreement should be priced at Westar's incremental costs, Westar argues that Occidental's cited case law is not applicable here because those cases address the treatment of off-system sales or concerned affiliate transactions.¹² Westar asserts that Occidental's concerns regarding affiliate abuse should also be dismissed because Westar and Kansas Electric are not affiliates.

15. In its answer, Kansas Electric states that Sunflower and Mid-Kansas' arguments should be dismissed because their member contracts are not affected by the proposed Agreement. Specifically, Westar would serve the full requirements of Kansas Electric as described in Article I of the proposed Agreement, which lists the retail load requirements of the member cooperatives at certain delivery points. Kansas Electric points out that the delivery points of Prairie Land and Victory served by Sunflower and Mid-Kansas are not listed in Article I of the proposed Agreement. Kansas Electric next asserts that protestors' arguments pertain to matters largely outside the scope of the Commission's review authority, that the arguments lack merit for legal and factual reasons, and that the protested provisions reflect the exercise of Kansas Electric's reasonable business judgment. Kansas Electric also answers that Occidental's argument that the demand charge cap is inconsistent with a truly embedded cost rate ignores the fact that the formula rate adjusts annually to protect against volatility and that retail customers pay a stated rate set by the Kansas Commission.

¹¹ Westar October 9, 2007 Answer, *citing Appalachian Power Co.*, Docket No. ER06-905-000 (June 8, 2006) (unpublished letter order) and *Kentucky Power Co.*, Docket No. ER06-340-000 (January 26, 2006) (unpublished letter order).

¹² *Id.* at 9.

16. Occidental asserts that Westar's answer has not provided any of the Non-FERC Form 1 data purportedly used in calculating the charges in Exhibit I.¹³ Occidental also argues that Westar's reliance on *Appalachian Power Co.* and *Kentucky Power Co.* is misplaced because these cases involve uncontested proposals accepted through delegated letter orders.

IV. Discussion

A. Procedural Matters

17. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2007), timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. We will grant the Kansas Cooperatives' untimely motion to intervene, given their interest in this proceeding, the early stage of the proceeding, and the absence of any undue prejudice or delay.

18. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2007), prohibits an answer to a protest or an answer to an answer unless otherwise ordered by the decisional authority. We will accept all of the answers because they have provided information that assisted us in our decision-making process.

B. Hearing and Settlement Judge Procedures

19. Westar's proposed Agreement raises issues of material fact that cannot be resolved based on the record before us, and that are more appropriately addressed in the hearing and settlement judge procedures ordered below.

20. Our preliminary analysis indicates that Westar's proposed Agreement has not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. Therefore, we will accept Westar's proposed Agreement for filing, suspend it for a nominal period,¹⁴ subject to refund, and set it for hearing and settlement judge procedures.

21. While we are setting these matters for a trial-type evidentiary hearing, we encourage the parties to make every effort to settle their dispute before the hearing procedures are commenced. To aid the parties in their settlement efforts, we will hold the

¹³ Occidental October 19, 2007 Answer at 3.

¹⁴ As mentioned previously, the Commission instituted a proceeding under FPA section 206 regarding sales charged under market-based rates by Westar in its control area. The Commission's Mitigation Order required that sales with terms of more than one year should be made on an embedded cost-of-service basis. Consistent with that finding, in this order, we will establish a November 1, 2007 effective date for this cost-based contract and make its underlying rates subject to further fact finding and refund.

hearing in abeyance and direct that a settlement judge be appointed, pursuant to Rule 603 of the Commission's Rules of Practice and Procedure.¹⁵ If the parties desire, they may, by mutual agreement, request a specific judge as the settlement judge in the proceeding; otherwise, the Chief Judge will select a judge for this purpose.¹⁶ The settlement judge shall report to the Chief Judge and the Commission within 30 days of the date of the appointment of the settlement judge, concerning the status of settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions or provide for commencement of a hearing by assigning the case to a presiding judge.

The Commission orders:

(A) Westar's proposed Agreement is hereby accepted for filing and suspended for a nominal period, to become effective as requested, subject to refund, as discussed in the body of this order.

(B) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by the Federal Power Act, particularly sections 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R., Chapter I), a public hearing shall be held concerning Westar's proposed Agreement. However, the hearing shall be held in abeyance to provide time for settlement judge procedures, as discussed in Ordering Paragraphs (C) and (D) below.

(C) Pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2007), the Chief Administrative Law Judge is hereby directed to appoint a settlement judge in this proceeding within fifteen (15) days of the date of this order. Such settlement judge shall have all powers and duties enumerated in Rule 603 and shall convene a settlement conference as soon as practicable after the Chief Judge designates the settlement judge. If the parties decide to request a specific judge, they must make their request to the Chief Judge within five (5) days of the date of this order.

(D) Within thirty (30) days of the appointment of the settlement judge, the settlement judge shall file a report with the Commission and the Chief Judge on the status of the settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions, if appropriate, or assign this case to a presiding judge for a trial-type evidentiary hearing, if appropriate. If

¹⁵ 18 C.F.R. § 385.603 (2007).

¹⁶ If the parties decide to request a specific judge, they must make their joint request to the Chief Judge by telephone at (202) 502-8500 within five days of this order. The Commission's website contains a list of Commission judges and a summary of their background and experience (www.ferc.gov – click on Office of Administrative Law Judges).

settlement discussions continue, the settlement judge shall file a report at least every sixty (60) days thereafter, informing the Commission and the Chief Judge of the parties' progress toward settlement.

(E) If settlement judge procedures fail and a trial-type evidentiary hearing is to be held, a presiding judge, to be designated by the Chief Judge, shall, within fifteen (15) days of the date of the presiding judge's designation, convene a prehearing conference in these proceedings in a hearing room of the Commission, 888 First Street, N.E., Washington, DC 20426. Such a conference shall be held for the purpose of establishing a procedural schedule. The presiding judge is authorized to establish procedural dates and to rule on all motions (except motions to dismiss) as provided in the Commission's Rules of Practice and Procedure.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.